

**Management Advisory Report: Improvements
Have Been Made in Processing Gift Tax
Payments and Associated Extensions to File**

April 2002

Reference Number: 2002-30-066

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

April 29, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF EMPLOYED
DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - Improvements Have Been
Made in Processing Gift Tax Payments and Associated
Extensions to File (Audit # 200130035)

This report presents the results of our follow up review of the processing of gift tax payments and associated extensions to file. The overall objective of this review was to evaluate the effectiveness of the corrective actions taken in response to the recommendations in our report entitled, *Significant Improvements Are Needed in Processing Gift Tax Payments and Associated Extensions to File* (Reference Number 2000-30-154, dated September 2000).

In summary, we found that the Internal Revenue Service (IRS) effectively implemented the corrective actions agreed upon. There appear to be improvements in the processing of gift tax payments and extensions to file gift tax returns.

Since we are making no recommendations in this management advisory report, a response is not required. Copies of this report are also being sent to the IRS managers affected by the report. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

**Management Advisory Report: Improvements Have Been Made in Processing Gift Tax
Payments and Associated Extensions to File**

Table of Contents

Background Page 1

Internal Revenue Service Actions Should Help Reduce Errors in
Processing Gift Tax Payments and Associated Extensions to File..... Page 1

Appendix I – Detailed Objective, Scope, and Methodology Page 4

Appendix II – Major Contributors to This Report..... Page 6

Appendix III – Report Distribution List Page 7

Management Advisory Report: Improvements Have Been Made in Processing Gift Tax Payments and Associated Extensions to File

Background

The processing of extensions to file gift tax returns and associated payments is currently performed at Internal Revenue Service (IRS) Submission Processing Centers and designated lockbox facilities. If these extensions and payments are not posted properly to taxpayer accounts, erroneous refunds are generated and incorrect notices are sent to taxpayers. This results in additional taxpayer burden, increased IRS processing costs, and increased risk of lost revenue.

Since 1989, several audit reports have been issued to the IRS regarding the incorrect processing of Applications for Automatic Extension of Time to File U.S. Individual Income Tax Return¹ (Forms 4868) and payments to gift tax accounts. This review evaluated the effectiveness of the corrective actions taken in response to the recommendations in our September 2000 report.²

The review was conducted at the Customer Accounts Services function in the Small Business/Self-Employed (SB/SE) Division's Headquarters, and the Brookhaven and Cincinnati Submission Processing Centers from August 2001 through January 2002. We conducted the review in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*. Detailed information on our objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Internal Revenue Service Actions Should Help Reduce Errors in Processing Gift Tax Payments and Associated Extensions to File

We found that the IRS effectively implemented the actions agreed upon in response to our previous report. To correct the problems with processing gift tax payments and associated extensions to file, the IRS took the following actions.

¹ Applications for extensions to file gift tax returns are included on the same form as applications for extensions to file individual income tax returns.

² *Significant Improvements Are Needed in Processing Gift Tax Payments and Associated Extensions to File* (Reference Number 2000-30-154, dated September 2000).

Management Advisory Report: Improvements Have Been Made in Processing Gift Tax Payments and Associated Extensions to File

- Internal Revenue Manual (IRM) instructions were revised for processing Forms 4868, to ensure that gift tax payments and extensions are processed to the proper taxpayer accounts.
- New Quality Review Lockbox Measures were developed, including updated versions that were forwarded to coordinators throughout the year.
- Lockbox guidelines were clarified for the processing of payments and extensions submitted by taxpayers “for gift tax only.”
- The Notice Review function has mandated the review of certain gift tax balance due notices to help prevent the issuance of erroneous notices and refunds.³

At one Submission Processing Center where we performed more in-depth testing, an additional action was taken to evaluate the quality of processing the payments and extensions. The Lockbox Coordinator requested that the IRS’ Management Accountability Review Team (MAR) review gift tax extensions that were processed through the lockbox for indications of processing errors. The Lockbox Coordinator reviewed extensions processed from January through April 2001, and the MAR Team reviewed extensions processed during April 2001. Of 23,110 extensions reviewed, only 41 misapplied payments were found. All 41 misapplied payments were subsequently corrected on the taxpayers’ accounts.

At the same Submission Processing Center, balance due notices for gift tax returns issued to taxpayers after the extended due date of August 15, 2001, decreased approximately 50 percent from the previous year. A decrease of misapplied payments appears to be the reason for the lower volume.

³ The IRS is still developing another tool to assist in the review of these balance due notices. Completion of this additional review tool has been delayed until January 10, 2003.

Management Advisory Report: Improvements Have Been Made in Processing Gift Tax Payments and Associated Extensions to File

Finally, our judgmental sample of 50 balance due notices for gift taxes also showed that the Notice Review function stopped 19 notices involving misapplied credits, thereby identifying and correcting errors made in processing.

Although the number of errors in our sample was high, there were only 200 such notices generated during the period August 13 through December 31, 2001, when most of these notices are generated.

Because of the IRS' reorganization into separate business units, we believe that the new SB/SE Division was better able to focus on the correction of these problems.

Previously, analysts had to cover both these gift tax issues and individual tax issues.

Detailed Objective, Scope, and Methodology

The overall review objective was to evaluate the effectiveness of the corrective actions taken in response to the recommendations in our prior report entitled, *Significant Improvements Are Needed in Processing Gift Tax Payments and Associated Extensions to File*.¹

To accomplish the objective, we:

- I. Determined whether the Internal Revenue Service (IRS) took effective corrective actions to ensure that gift tax payments and associated gift tax extensions were processed correctly and timely.
 - A. Reviewed corrective actions taken by the IRS to resolve processing problems as a result of previous audit findings and recommendations.
 1. Reviewed the IRS Commissioner's response to the original report to identify which findings required a corrective action on the part of the IRS and identified how and when the corrective action was implemented.
 - B. Evaluated the adequacy / effectiveness of corrective measures taken.
 1. Interviewed appropriate Customer Accounts Services staff to obtain information and input regarding corrective procedures and controls.
 - a) Interviewed the Senior Operations Advisor and Management Analysts responsible for corrective actions.
 - b) Compared current lockbox procedures to previous procedures to ensure that corrective measures had been implemented.
 - c) Compared the Internal Revenue Manual (IRM) to the previous year's IRM to ensure corrective measures had been implemented.
 - d) Evaluated the adequacy of new training material used and when training occurred.
 - C. Interviewed processing personnel at one Submission Processing Center to determine if new procedures were effective and adhered to.
 - D. Reviewed a judgmental sample of gift tax payments and associated extensions to file to determine if they were processed correctly.

¹ *Significant Improvements Are Needed in Processing Gift Tax Payments and Associated Extensions to File* (Reference Number 2000-30-154, dated September 2000).

Management Advisory Report: Improvements Have Been Made in Processing Gift Tax Payments and Associated Extensions to File

1. At one Submission Processing Center, we determined the number of balance due notices (CP 161) generated for gift tax returns for Tax Year (TY) 2000 and compared to TY 1999 to determine if there was a decrease in the number of notices issued. Evaluated whether the corrective actions significantly reduced the number of these erroneous notices and corresponding erroneous Individual Masterfile² refunds.
2. Selected a judgmental sample of 50 CP 161 notices generated from August 2001 through November 2001³ for issuance to taxpayers who filed gift tax returns for TY 2000, in order to identify misapplied credits from the filing of gift tax extensions. A judgmental sample was used because statistical projections were considered to be unnecessary. Performed research on these cases on the Integrated Data Retrieval System.⁴

² The Individual Masterfile is the main IRS computer system containing the accounts of individual taxpayers.

³ This is the time frame during which the standard 4-month extension expires, and is one of the peak times for the generation of CP 161 notices for gift tax returns. There were a total of 200 CP 161 notices issued for gift tax returns at the one Submission Processing Center during the period August 13 through December 31, 2001.

⁴ The Integrated Data Retrieval System is the IRS' computer system that allows employees to research taxpayers' accounts.

Major Contributors to This Report

Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business & Corporate Programs)

Richard J. Dagliolo, Director

Robert K. Irish, Audit Manager

Paul R. Baker, Auditor

Dolores M. Castoro, Auditor

**Management Advisory Report: Improvements Have Been Made in Processing Gift Tax
Payments and Associated Extensions to File**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Deputy Commissioner, Small Business/Self-Employed Division S
Director, Customer Accounts Services, Small Business/Self-Employed Division S:CAS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaison:
 Commissioner, Small Business/Self-Employed Division S